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No. 89-604

In The

Supreme Court of the United States

October Term, 1989

ERNST & WHINNEY,

Petitioner,

v.

BRADFORD-WHITE CORPORATION,

Respondent.

BRADFORD-WHITE CORPORATION'S BRIEF IN OPPOSITION TO ERNST & WHINNEY'S PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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STATEMENT OF THE CASE

At the heart of this dispute are the certified financial statements of the W.L. Jackson Manufacturing Company ("Jackson Co.") which were audited for Jackson Co. by Petitioner Ernst & Whinney, a national accounting firm, and as specifically determined by the jury, contained material misrepresentations and omissions. In the early '70s, Ernst & Whinney was engaged by the Jackson Co. to act as its independent auditor, and Ernst & Whinney served in that capacity through the audit of Jackson Co. as of June 30, 1981. In April 1981, Ernst & Whinney issued its opinion on the consolidated financial statements of Jackson Co. as of December 31, 1980. In that opinion, Ernst & Whinney represented and warranted that:

> Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

(E&W App. 85)[1] Ernst & Whinney also represented that, subject to and except for certain qualifications, the consolidated financial statements fairly presented the financial position of Jackson Co., the results of its operations, and changes in financial position, "in conformity with generally accepted accounting principles applied on a consistent basis." (E&W App. 86-87) On the basis of Jackson Co.'s December 1980 financial statements, as audited and certified by Ernst & Whinney, Jackson Co.'s net worth was $1,793,203.00. (E&W App. 12, 56)

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[1] References to the Appendix found in Ernst & Whinney's Petition for Writ of Certiorari will be referred to throughout this Brief in Opposition as "E&W App. ___." References to the Appendix found in this Brief will be referred to as "B-W App. ___".

In mid-June, 1981, Bradford-White Corporation ("Bradford-White")[2] began negotiating the purchase of Jackson Co. Time was of the essence such that Bradford-White relied primarily upon Ernst & Whinney's certified audit of the Jackson Co.'s financial statements and its opinion as to Jackson Co.'s financial condition as of December 1980, in consummating a Stock Purchase Agreement ("the Agreement") with the individual stockholders of Jackson Co. The purchase price for the Jackson Co. was to be determined on the basis of the company's net worth as of June 30, 1981. (E&W App. 13, 54-55) The Agreement provided that Ernst & Whinney, once again, would serve as Jackson Co.'s independent auditor of its financial statements. (E&W App. 13, 56)

Although Bradford-White had known it was purchasing a troubled company, the depth of the financial problems and irretrievability of the situation was concealed by the information presented to Bradford-White in the financial statements of the Jackson Co. audited by Ernst & Whinney. Moreover, Bradford-White had no reason to believe that the financial condition of Jackson Co. – however one chose to characterize it – was materially worse than, or different from, that represented by Ernst & Whinney.

Following the consummation of the Agreement, Ernst & Whinney commenced the audit of Jackson Co. as provided by the terms of the Agreement. As the months passed, Bradford-White came to realize that the true nature and extent of Jackson Co.'s financial problems were multi-faceted, as was its concealment in the certified

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[2] Bradford-White Corporation is a wholly-owned subsidiary of S.A. Brewing Holdings Limited of Adelaide, South Australia. S.A. Brewing Holdings Limited purchased Bradford-White Corporation from Nortek, Inc. in October of 1989. Nortek, Inc., as part of the sale, took an assignment from Bradford-White Corporation, by which it has the sole right to prosecute this action in the name of Bradford-White Corporation and to receive the proceeds of any judgment ultimately awarded to the Bradford-White Corporation.

financial statements. Ernst & Whinney's own June 1981 audit ultimately revealed significant, material and adverse changes as compared to the year-end December 1980 audited financials. Jackson Co.'s net worth was suddenly a *negative* $3,606,647.00. (E&W App. 13, 56) This reflected a negative swing in net worth of almost 5.4 million dollars in a six-month period. Rather than acquiring a poorly managed company with working capital problems, Bradford-White found itself in possession of an asset-depleted, liability-ridden company on the verge of bankruptcy. It then became apparent that Ernst & Whinney's false and misleading opinion on the financial statements for year-end December 1980 had masked the true state of the Jackson Co.'s financial condition.

Bradford-White filed its Complaint against Ernst & Whinney in July 1983 in the United States District Court for the Eastern District of Pennsylvania ("district court"). In July 1986, a jury trial was commenced which ran thirteen days. The district court duly instructed the jury on the elements of a 10b-5 cause of action, and on Tennessee law with regard to intentional misrepresentation, negligent misrepresentation and negligence/professional malpractice - Bradford-White's pendent state law claims. Ernst & Whinney made no objection on the record to the court's instruction to the jury on the elements of a 10b-5 cause of action. (B-W App. 25-27) Nor, did Ernst & Whinney object when the district court instructed the jury that by answering "yes" to special interrogatories 1-3, the jury would be returning a verdict in favor of Bradford-White and against Ernst & Whinney on the 10b-5 claim. (B-W App. 22, 25-27, 30-31)

At no time either prior or during the trial did Ernst & Whinney make any motion or present any affirmative evidence in support of a statute of limitations defense, (E&W App. 24-25, 65-66), which affirmative defense had merely been plead in its initial answer to Bradford-White's complaint. Moreover, Ernst & Whinney did not request any instruction or charge to the jury on the issue

of the statute of limitations being a bar to Bradford-White's federal securities claim. (B-W App. 25-28)

On July 25, 1986, the jury rendered its answers to special interrogatories which conclusively established that Ernst & Whinney had violated Section 10(b) and Rule 10b-5, such that the district court appropriately entered judgment in favor of Bradford-White. However, in ruling on the various post trial motions, the district court erred in failing to reconcile an alleged inconsistency in the jury's findings of fact. The district court's Order of August 25, 1987, *inter alia*, vacated the judgment which had been entered, thereby nullifying the jury's verdict in favor of Bradford-White, and directed that judgment be entered in favor of Ernst & Whinney on the pendent state law claims. (E&W App. 48-49) The district court then ordered that a new trial be held solely on the federal securities claim. (E&W App. 48-49) The district court, however, found that as to the first trial, Ernst & Whinney had waived the statute of limitations affirmative defense. (E&W App. 65-66)

Pending the commencement of the second trial, Ernst & Whinney filed a motion for summary judgment alleging that Bradford-White's federal securities claim was time-barred as a result of the newly announced statute of limitations for 10b-5 actions in *In re: Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.), *cert. denied*, 109 S.Ct. 131 (1988). The district court, applying *Data Access* retroactively, granted Ernst & Whinney's motion for summary judgment and dismissed Bradford-White's remaining federal claim. (E&W App. 32-47)

On timely appeal to the United States Court of Appeals for the Third Circuit ("Court of Appeals"), Bradford-White asserted, *inter alia*, that the district court erred in not reconciling the jury's answers to special interrogatories, in violation of the Seventh Amendment and Supreme Court precedent. Further, Bradford-White specifically argued that if the Court of Appeals found the jury's answers to be consistent and/or reconcilable, and reinstated the original judgment in Bradford-White's

favor, then the Court of Appeals need not address the statute of limitations defense, since that defense was waived by Ernst & Whinney during the first trial.

The Court of Appeals, in reviewing the jury's answers to special interrogatories in accordance with the protections of the Seventh Amendment and the precedent of this Court, carefully articulated the manner in which the jury's answers could be harmonized. In so doing, the Court of Appeals implicitly, if not explicitly, determined that the elements of scienter and loss causation had been satisfied.[3] (E&W App. 18-19, 22-23) Having found the jury's answers to establish a 10b-5 violation, the Court of Appeals further determined that any statute of limitations defense Ernst & Whinney may have had was waived by the end of the trial. (E&W App. 23-25) The new statute of limitations announced in *Data Access*, the Court of Appeals concluded, could not be asserted by Ernst & Whinney to avoid the entry of judgment in Bradford-White's favor on remand. Ernst & Whinney then filed a Petition with the Court of Appeals for Rehearing which was denied. (E&W App. 1-2) The present Petition for a Writ of Certiorari by Ernst & Whinney thereupon followed.

SUMMARY OF ARGUMENT

Ernst & Whinney, by ignoring the jury charge delivered by the district court and the jury's answers to special interrogatories, has attempted to twist the rather straightforward two issues presented to, and properly resolved by, the Court of Appeals into a reincarnation of *Ernst &*

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[3] Neither "loss causation" nor "scienter" as such were *issues* on appeal since the district court had instructed the jury properly on both of these elements of a 10b-5 action, (B-W App. 8-11, 17-18), and no exception was taken by Ernst & Whinney to either the court's charge on these elements, nor did Ernst & Whinney request a separate and specific interrogatory to the jury on "loss causation" as regards the 10b-5 action. (B-W App. 25-27)

Ernst v. Hochfelder, 425 U.S. 185 (1976)(hereinafter "*Hochfelder*"). But this Court need not be concerned about either a frontal or rear assault upon its prior rulings in *Hochfelder*, since such issues are absent from this case. The only issues properly before, and decided by, the Court of Appeals were: (1) are the jury's answers to the special interrogatories reconcilable so as to warrant the reinstatement of the judgment in favor of Bradford-White in this case; and if so, (2) did Ernst & Whinney waive the defense of the applicable statute of limitations during the first trial as found by the district court. Since neither of the real issues decided by the Court of Appeals in this case would present even an arguable basis upon which this Court should exercise its discretionary jurisdiction, Ernst & Whinney has woven a new pattern to present to the Court.

Contrary to Ernst & Whinney's protest that loss causation and scienter received short shrift by the courts below, the district court properly charged the jury on both of these elements (B-W App. 8-11, 17-18), and Ernst & Whinney neither objected to the district court's charge, nor did it request different or more expansive interrogatories to be submitted to the jury. Indeed, no suggestion has been made in the courts below that these elements were absent from the district court's charge or the special interrogatories. As the Court of Appeals was required to do, it simply read the jury's answers to the special interrogatories "in a manner which reconcile[d] them with the jurors' probable intention in light of the Court's instruction." (E&W App. 21, citation omitted) The Court of Appeals recognized that the loss causation argument which Ernst & Whinney has attempted to construct is belied by its own audits which demonstrated a dramatic downward change of approximately 5 1/2 million dollars in the company's net worth between December 31, 1980 and June 30, 1981. The Court of Appeals then properly affirmed the district court's determination that, during the course of the trial, Ernst & Whinney had

waived the statute of limitations defense and, therefore, the retroactivity of *Data Access* was not at issue.

Accordingly, there is no question for review which falls within the parameters of Supreme Court Rule 17.1(c). Ernst & Whinney's arguments that the Court of Appeals' interpretation of the jury's findings of fact somehow collide with the Seventh Amendment, or are an affront to *Hochfelder*, or establish a division in the circuits on loss causation, are simply chimerical. Without any allegation of, or objection to, an erroneous charge to the jury by the trial court on the elements of a 10b-5 cause of action, then the ability of the Court of Appeals to find a view of this case which reconciles the jury's answers, necessarily establishes liability and complies with the dictates of the Seventh Amendment.

ARGUMENT IN OPPOSITION TO GRANTING THE WRIT

I. THE JURY SPECIFICALLY FOUND THAT ERNST & WHINNEY MADE MATERIAL MISREPRESENTATIONS AND/OR OMISSIONS IN THE PERFORMANCE OF A GAAS AUDIT, WITH SCIENTER, THAT WERE REASONABLY RELIED UPON BY BRADFORD-WHITE AND THAT CAUSED BRADFORD-WHITE'S DAMAGES

Having harmonized the jury's answers to the special interrogatories, which establish a Rule 10b-5 violation by Ernst & Whinney, as required by the Seventh Amendment of the United States Constitution and the law as pronounced by this Court, the Court of Appeals further found that any possible statute of limitations defense that Ernst & Whinney may have had was waived by its undisputed failure to establish this affirmative defense either before or during the trial.

Given its obvious disagreement with the Court of Appeals' interpretation of the jury's findings of fact, Ernst & Whinney now, in seeking a writ of certiorari, essentially asserts that the Court of Appeals has found

10b-5 liability upon mere negligence in violation of this Court's decision in *Hochfelder*,[4] and that the Court of Appeals' opinion "implicitly" disagrees with another appellate court on the establishment of loss causation. Despite its efforts, Ernst & Whinney's Petition does not present any question for review which is novel or new; nor, does it bring into question an appellate decision which is, in fact, in contravention of any holding of this Court, or any sister appellate court. Rather, Ernst & Whinney is actually seeking a redetermination by this Supreme Court of the *facts* in this case, as found by the jury. That, Bradford-White respectfully submits, would fly in the face of the Seventh Amendment and the sanctity of the jury's findings.

In attempting to establish some ground for invoking the jurisdiction of this Court pursuant to Supreme Court Rule 17.1(c), Ernst & Whinney wrongfully asserts that its material misrepresentation regarding the conduct of a GAAS audit was merely negligent, and further, attempts to impose the jury's findings of fact on the state law claims to dispel the jury's findings on Bradford-White's federal securities claim. Although the Seventh Amendment and the law of this Court require that the jury's answers to the various interrogatories be reconciled, no party or court "can redetermine facts found by the jury," *Atlantic and Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355, 358-59, 363 (1962), nor read the answers in a manner which contravenes "the jurors' probable intention in light of the Court's instructions." *Scott v. Plante*, 641 F.2d 117, 125 (3d Cir. 1981), *vacated on other grounds*,

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[4] Ernst & Whinney also makes passing reference to *Santa Fe Industries v. Green*, 430 U.S. 462 (1977), as a pretext for establishing grounds for the granting of a writ of certiorari pursuant to Sup. Ct. R. 17.1(c). Yet, Ernst & Whinney never really sets forth how the Court of Appeals' opinion is in conflict with *Santa Fe*. Nevertheless, Ernst & Whinney's "reliance" on *Santa Fe* is misplaced, as this is not a mere case of corporate mismanagement.

458 U.S. 1101 (1982); *see also Jones & Laughlin Steel Corp. v. Johns-Mansville Sales Corp.*, 626 F.2d 280, 293 (3d Cir. 1980); *Barnhart v. Dollar Rent A Car Systems, Inc.*, 595 F.2d 914, 919 (3d Cir. 1979).

Ernst & Whinney's misstatement in its opinion regarding the conduct of the Jackson Co. audit in accordance with GAAS was not mere failure to disclose its own negligence.[5] Rather, as the district court conceded and the Court of Appeals affirmed in reviewing and reconciling the jury's answers to special interrogatories, the audit performed by Ernst & Whinney was so "shoddy" as to amount to a "pretend audit," such that Ernst & Whinney's "flimsy" statement regarding its performance of a GAAS audit was an intentional and/or reckless statement subjecting it to 10b-5 liability. (E&W App. 80-81); *see McLean v. Alexander*, 599 F.2d 1190, 1198 (3d Cir. 1979).

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[5] Ernst & Whinney attempts throughout its Petition to cause the Court of Appeals' decision to collide with the mandates of *Hochfelder* by muddling the elements of materiality and scienter. Even if Ernst & Whinney's argument that "[i]n decreeing liability for mere failure to disclose negligence, the Court of Appeals has made an end run around *Hochfelder*'s scienter requirement", (Petition of Ernst & Whinney, at 2), had any basis in fact in the context of this case, it would fail on its lack of merit. As this Court well knows, *Hochfelder* determined, *inter alia*, that mere negligence was not sufficient to support a finding of a 10b-5 violation. *Hochfelder* did not, and obviously should not be read to, find that if the material misrepresentation concerned the negligence of the defendant and such misrepresentation was made with scienter, it would not support a 10b-5 violation. An example would be one where a seller of a security interest in a hotel, which the seller developed, knew that the hotel was negligently built using the wrong sized support beams, but the prospectus represented that the hotel had been built to certain engineering specifications which implemented the correctly sized support beams. The seller, therefore, would have made a material misrepresentation

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What Ernst & Whinney has done in its Petition is twist and mix the jury's answers to special interrogatories to fabricate inconsistencies and conflicts with settled law. Given that this action was submitted to a jury on eleven (11) special interrogatories, with no general verdict interrogatory, after a 13-day trial, it is so fact sensitive that the granting of a writ of certiorari by this Court will do nothing to clarify or advance the state of the law with regard to 10b-5 liability.[6] Any decision on the merits by this Court would necessarily require an evaluation of the jury's findings of fact and compel this Court to adopt a view of the case which renders them consistent. This, the Court of Appeals has already done.[7]

(Continued from previous page)

regarding his negligence with scienter. Clearly, an investor who relies on the representation and who suffers a loss when the hotel collapses would have a 10b-5 claim for the knowing misrepresentation by the seller of "failing to disclose his own negligence." Here the jury found specifically that Ernst & Whinney had made such a material misrepresentation with scienter which was reasonably relied upon by Bradford-White and which caused Bradford-White to suffer a loss.

[6] "An issue of fact is not 'important' for purposes of R.17. Normally, the Court will not grant certiorari to review a decision that turns solely upon an analysis of facts, or to determine whether the evidence supports a judgment of a district court or an administrative agency. As to such issues, the courts of appeals are generally the courts of last resort . . . " 13 J.W. Moore, H.I. Bendix & B.A. Ringle, *Moore's Federal Practice* Para. 817.41, SC17-43, SC17-44 & n.31 (2d ed. 1988); *see also* 13 *Moore's Federal Practice* Paras. 817.21 nn.9 & 13, 817.45.

[7] The weakness and desperation of Ernst & Whinney's arguments are exemplified in its repetition of the claim that Bradford-White's counsel at oral argument "all but conceded" a *contradiction* in the answers to the special interrogatories at the time of argument on the post trial motions, as stated in the

(Continued on following page)

A. The Jury's Finding of Fact With Regard To Bradford-White's 10b-5 Cause of Action Establishes A Level of Scienter Which Comports With This Court's Teachings In *Hochfelder*.

Ernst & Whinney's statement that Bradford-White bases its claim solely on Ernst & Whinney's failure to disclose its own negligence in the performance of a GAAS audit is not only wrong, it is in direct contradiction of the jury's findings and the opinions of the lower courts, such that Ernst & Whinney's reliance on *Hochfelder* is seriously misplaced. The procedural posture of *Hochfelder* when it reached this Court for review was so dramatically different from the instant case that there is no true analogy that can be drawn between these two cases. The teachings of *Hochfelder* are relevant to this action solely to the extent that it established that some degree of scienter was necessary to impose 10b-5 liability, as opposed to mere negligent conduct alone. *Hochfelder*, 425 U.S. at 201.

In *Hochfelder*, the complaint against the accounting firm of Ernst & Ernst alleged that Ernst & Ernst had aided and abetted a 10b-5 violation by its failure to conduct a proper audit. Discovery revealed that plaintiff's cause of action against Ernst & Ernst was premised "on a theory of negligent nonfeasance" alone, as plaintiff's answers to interrogatories revealed that they were " 'not accus[ing] Ernst & Ernst of deliberate, intentional fraud,' merely with 'inexcusable negligence.' " *Id.*, at 190 n.5. Moreover, plaintiffs had "conceded that they did not rely on the financial statements and reports prepared by Ernst &

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district court's opinion. (E&W App. 82) Obviously, the issue of whether the district court *believed* that counsel all *but* conceded a *contradiction* is not at all relevant, since the issue is whether any alleged inconsistency can be reconciled and Bradford-White has *always* argued that the answers are reconcilable and the Court of Appeals agreed.

Ernst *or on its certificate of opinion.*" *Id.*, at 192 n. 9 (emphasis added).[8]

In ruling on Ernst & Ernst's motion for summary judgment, the district court was also able to conclude "that there was no genuine issue of material fact with respect to whether Ernst & Ernst had conducted its audits in accordance with generally accepted auditing standards," i.e., GAAS. *Id.*, at 191 (footnote omitted). Thus, when the *Hochfelder* case reached this Court, the question was "whether a private cause of action for damages will lie under § 10(b) and Rule 10b-5 in the *absence of any allegation of* 'scienter' – intent to deceive, manipulate, or defraud." *Id.*, at 193 (emphasis added). The holding in *Hochfelder* was ultimately that the language of Section 10(b) and the intent of Congress addresses "practices that involve some element of scienter and cannot be read to impose liability for negligent conduct alone." *Id.*, at 201. However, this Court further explained that:

> In this opinion the term "scienter" refers to a mental state embracing intent to deceive, manipulate, or defraud. In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under § 10(b) and Rule 10b-5.

Id., at 193 n. 12.

Every circuit court since *Hochfelder* has adopted a recklessness[9] standard to satisfy the scienter requirement

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[8] The jury in the case at bar specifically found that Bradford-White had reasonably relied upon Ernst & Whinney's express statement in its opinion that it had conducted its audit in accordance with GAAS, and that such a misrepresentation was material and made by Ernst & Whinney with scienter.

[9] It is significant to note that Ernst & Whinney has not challenged, at any point in this litigation, the recklessness standard as being insufficient to establish the scienter requirement for a Rule 10b-5 violation, nor the district court's charge to the jury on what would constitute scienter.

for 10b-5 liability. *See* J.P. Bolger, *Recklessness and the Rule 10b-5 Scienter Requirement After Hochfelder*, 48 Fordham L. Rev. 817, 818-19 (1980); *see also SEC v. American Realty Trust*, 429 F. Supp. 1148, 1171 (E.D. Va. 1977), *rev'd on other grounds*, 586 F.2d 1001 (4th Cir. 1978).

Hochfelder reached the Supreme Court following the lower courts' rulings on the propriety of granting defendant's motion for summary judgment, which necessarily implicated the sufficiency of the pleadings against the accounting firm. In this action, however, a full 13-day trial was held on the federal securities claim establishing each and every element necessary to sustain a finding of 10b-5 liability, including scienter. (E&W App. 18-19, 27-30, 73-77) Ernst & Whinney did not, in the lower courts, nor does it now, object to the district court's instructions to the jury on the 10b-5 cause of action; and, therefore, despite Ernst & Whinney's feigned protests to the contrary, the issue is whether the jury's answers to the special interrogatories which undeniably delivered a verdict in the Rule 10b-5 action in favor of Bradford-White, are consistent or reconcilable.[10]

The jury specifically found that Ernst & Whinney made a material misrepresentation and/or omission in stating that its audit of Jackson Co. was conducted in accordance with GAAS. (Interrogatory 1(f), E&W App. 27) It then found that this material misrepresentation was made with scienter, i.e. *either* with knowledge that it was false or misleading, or with reckless indifference as to its

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[10] It is of interest to note that at the time the jury delivered its answers to the special interrogatories, there was no question by either the district court or Ernst & Whinney's counsel that the jury had returned a verdict on the 10b-5 claim in favor of Bradford-White. Indeed, counsel for Ernst & Whinney immediately asked to have the jury polled - an action not normally taken by a party who believes the verdict is in its favor - and the district court entered judgment against Ernst & Whinney on the 10b-5 claim based upon the jurors answers. (B-W App. 35-38; E&W App. 88)

falsity. (Interrogatory 2, E&W App. 28) Finally, the jury concluded that Bradford-White reasonably relied upon this false statement in deciding to buy the stock of Jackson Co. (Interrogatory 3, E&W App. 28)

In instructing the jury on the scienter requirement, the district court stated in part:

> Now to prove the second part of misrepresentation under rule 10(b)(5), plaintiff must prove by a preponderance of the evidence that Ernst & Whinney made the untrue statement or omitted necessary clarifying information either:
>
> One, with the knowledge that the statement was false; or that the omission would make a statement false or misleading.
>
> Two, with reckless indifference as to whether or not it was true. Recklessness may exist when a defendant has reason to know of a material misstatement or omission, but fails to cure it though it could have done so without great effort.
>
> *It is not enough for a violation of section 10(b)(5) that the defendant was simply careless or negligent.*

(B-W App. 9-10, emphasis added)

Ernst & Whinney made no objection to the 10b-5 charge to the jury, (B-W App. 25-27), nor does it now argue that the scienter requirement for 10b-5 liability should not include recklessness. Consequently, Ernst & Whinney's statement that Bradford-White "bases its claim solely on a failure to *disclose* negligence," (Petition of Ernst & Whinney, at 12), is patently false.[11]

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[11] Rather than what Ernst & Whinney characterizes as the basis of Bradford-White's claim, the jury found that Ernst & Whinney made a *material* misrepresentation as to the type of audit it conducted. Under Ernst & Whinney's theory, had Ernst & Whinney not done an audit at all (which the district court all but said was the case), yet represented in its

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Moreover, Ernst & Whinney misinterprets *Hochfelder*'s "affirmance" of the district court's grant of summary judgment. (Petition of Ernst & Whinney, at 13) The district court in *Hochfelder* had found, as a matter of law, that there "was no genuine issue of material fact with respect to whether Ernst & Ernst had conducted its audits in accordance with [GAAS]." *Hochfelder*, at 191 (footnote omitted). The Supreme Court did not remand the action for further proceedings because it concluded that plaintiff was proceeding solely "on a theory of liability premised on negligence, specifically disclaiming that Ernst & Ernst had engaged in fraud or intentional misconduct." *Id.*, at 215 (footnote omitted). Thus, *Hochfelder* does *not* hold, as proffered by Ernst & Whinney, that "non-compliance with GAAS [will not] suffice under Rule 10b-5 even if it leads to misstated numbers – unless plaintiff proves 'intent to defraud.' " (Petition of Ernst & Whinney, at 13) Such a statement by Ernst & Whinney to this Court evidences either its total miscomprehension of *Hochfelder*'s holding, or a futile attempt to concoct a *Hochfelder* theory in the hopes of obtaining a grant of its Petition.

B. The Jury's Finding of Fact With Regard to Causation For Common Law Intentional Misrepresentation Does Not Contravene *Hochfelder*.

Ernst & Whinney purposely attempts to render the jury's answers to special interrogatories inconsistent and bypass the finding of 10b-5 liability by taking the answer

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opinion that it *had* done an audit in accordance with GAAS, that would simply constitute a failure to disclose negligence, and therefore, not be actionable under *Hochfelder*. Clearly, that is not what was intended by *Hochfelder* and Ernst & Whinney knows it. Otherwise, the certification by a big eight accounting firm such as Ernst & Whinney that it conducted its audit in accordance with certain professional guidelines would be a mere sham upon the investing public.

to Interrogatory 5 (E&W App. 29), relative to the causation requirement for intentional misrepresentation under Tennessee common law, and imposing it over the jury's findings on the federal securities claim in answer to Interrogatories 1-3. (E&W App. 27-29) This argument by Ernst & Whinney is tantamount to playing the old "shell" game with this Court, and since Ernst & Whinney was aware of the trial court's instructions to the jury with regard to this interrogatory, such an argument borders on intellectual dishonesty. In attempting to reconcile the jury's answers to special interrogatories, as mandated by the Seventh Amendment and legal precedent, it is necessary to segregate and review the answers per cause of action in light of the trial court's instructions to the jury. *Atlantic and Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355 (1962); *Scott v. Plante*, 641 F.2d 117 (3rd Cir. 1981), *vacated on other grounds*, 458 U.S. 1101 (1982); *Jones & Laughlin Steel Corp. v. Johns-Mansville Sales Corp.*, 626 F.2d 280 (3rd Cir. 1980); *Barnhart v. Dollar Rent A Car Systems, Inc.*, 595 F.2d 914 (3rd Cir. 1979). The district court was careful to instruct the jury not only on the law for the federal securities claim and common law claims, but also to advise the jury that Interrogatories 1-3 pertained to the 10b-5 cause of action. As Ernst & Whinney well knows, the district court clearly stated that Interrogatory 5 related to common law intentional misrepresentation. (E&W App. 69-70; B-W App. 18-21, 30-31) Viewing the jury's answers to the special interrogatories in the manner presented to the jury in the court's charge renders them logically consistent.

On the choice of law question, the district court determined that Tennessee had the most significant contacts with this action (E&W App. 66-67), and thus, instructed the jury on Tennessee law with regard to Bradford-White's pendent state law claims. The burden of proof for intentional misrepresentation under Tennessee law is "clear and satisfying" evidence, *Russell v. Zanone*, 55 Tenn. App. 690, 404 S.W. 2d 539 (1966); (B-W App. 14),

which standard is certainly greater than the "preponderance of the evidence" standard applicable to a Rule 10b-5 claim. *Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); (B-W App. 3-4, 8-10) More significantly, the special interrogatory presented to the jury on intentional misrepresentation had to do with *causation*, and *not scienter*. Under Tennessee law, a reckless misrepresentation satisfies the scienter requirement, just as it does on a Rule 10b-5 claim. *Jasper Aviation, Inc. v. McCollum Aviation, Inc.*, 497 S.W. 2d 240 (Tenn. 1972); *Tartera v. Palumbo*, 224 Tenn. 262, 453 S.W. 2d 780 (1970); (B-W App. 14) However, causation for common law intentional misrepresentation liability requires a specific intent to defraud. Tennessee Pattern Jury Instructions – Civil 8.41 (West Supp. 1985); (B-W App. 14-15) Thus, the jury was presented with a special interrogatory on causation for the state law claim of intentional misrepresentation, i.e. Interrogatory 5.

The jury's finding that Bradford-White did not establish by "clear and satisfying" evidence that Ernst & Whinney made false statements with the specific "intent to defraud", therefore, can only render judgment in Ernst & Whinney's favor on Bradford-White's common law intentional misrepresentation claim under Tennessee law, which judgment was entered by the trial court. This finding, however, does not contravene *Hochfelder*, nor does it negate the jury's findings of fact establishing 10b-5 liability. *Hochfelder*'s holding requiring an "intent to deceive, manipulate, or defraud" related specifically and solely to the scienter requirement of 10b-5 liability, not causation. *Hochfelder*, 425 U.S. at 193. Moreover, the jury's findings of fact for 10b-5 liability were separate and distinct from the Tennessee common law interrogatories – the findings for one were not dependent on the findings for the other.[12] This was made clear to both the jury and

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[12] The trial court found no confusion or inconsistency in the jury's responses to special interrogatories 2 and 5, given

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the parties without objection by Ernst & Whinney. The district court on at least two occasions specifically instructed the jury that affirmative answers to special interrogatories 1-3 would constitute a verdict in favor of Bradford-White on the 10b-5 claim. (B-W App. 22, 30) This was done without objection or request for clarifying instructions by Ernst & Whinney.

As for the individual line items which the jury found to be materially misstated, i.e. inventory, net worth, and net loss (Interrogatory 1(a), (d)-(e), E&W App. 27), Ernst & Whinney makes much ado over the fact that the jury did not find that these misrepresentations were made with scienter, and criticizes the lower courts for referring to these misstatements to illustrate what Ernst & Whinney's compliance with GAAS would have revealed about the Jackson Co. (Petition of Ernst & Whinney, at 13) The jury's findings of fact with regard to these line items merely emphasizes the care the jury took and the consistency of its Rule 10b-5 findings. The jury was specifically instructed that the finding of any material misrepresentation, with scienter, that was reasonably relied upon by Bradford-White and thereby caused Bradford-White's damages, would suffice for 10b-5 liability. (B-W App. 17-20, 22, 30) There can be no denying that the jury found this liability in Ernst & Whinney's false statement regarding the manner in which it conducted its audit. (E&W App. 27-29) In reconciling the various answers to the subparts of Interrogatory 1, both the trial court and the Court of Appeals referred to the materially

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that the jury could have reasonably concluded that Bradford-White had not sustained its burden of proof for intentional misrepresentation. (E&W App. 71) The Court of Appeals did not address this issue as it found the jury's answers to the special interrogatories reconcilable in establishing a federal securities claim violation, and thus, did not review the judgment in favor of Ernst & Whinney on the state law claims. (E&W App. 11)

misstated line items as examples of the failed GAAS audit and its consequences. (E&W App. 22-23, 73-81) Since Ernst & Whinney had failed to perform a GAAS audit, as it affirmatively represented that it had, Ernst & Whinney may not have known that the individual line items were grossly overstated, as demonstrated by Ernst & Whinney's own audit six months later.[13] Thus, Ernst & Whinney's own second audit demonstrates the requisite "loss causation", precipitated by Bradford-White's reasonable reliance on Ernst & Whinney's representation that it had done a GAAS audit the first time.

No matter how many views of the jury's answers to special interrogatories Ernst & Whinney concocts in any number of seemingly contradictory ways, there need be but one view of the case which reasonably reconciles these answers, and that harmonious interpretation must be adopted by the courts. *Atlantic and Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355, 363 (1962); *Jones & Laughlin Steel Corp. v. Johns-Mansville Sales Corp.*, 626 F.2d 280, 293 (3d Cir. 1980).

C. The District Court and Court of Appeals found the Establishment of Loss Causation for 10b-5 Liability To Have Been Satisfied in Accordance With the Law As Applied By the Second, Third and Fifth Circuits.

There is no implicit disagreement between the Court of Appeals' opinion in this action and the law as applied by the Second or Fifth Circuits with regard to the establishment of loss causation.[14] To the contrary, the district

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[13] The second audit demonstrated a swing in net worth from the first audit, from $1,793,203 to a negative $3,606,647. (E&W App. 56)

[14] Ernst & Whinney has never argued in the lower courts, nor does it presently, that there was any deficiency in the trial court's charge to the jury on loss causation, nor did it request a

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court, in ruling on Ernst & Whinney's post-trial motions, specifically referred to and relied upon decisions in the Second and Fifth Circuits (E&W App. 74-75), in concluding that:

> [Bradford-White] also argues that had a GAAS audit been conducted, Ernst & Whinney would have uncovered material information as to inventory, product warranty liability, net worth and net income, all of which the jury concluded were materially misstated in the 1980 financial statements. I agree. The misstatements which resulted from the non-GAAS audit caused [Bradford-White] to be without knowledge of the true risks inherent in the purchase of the Jackson Co.

(E&W App. 76-77)

The Court of Appeals directly referred to this language from the district court's decision in holding that the jury's answers to special interrogatories are reconcilable. (E&W App. 22-23)

Though this Court has not engaged in a detailed, separate analysis of the loss causation requirement as such, it has reviewed the "in connection with" language found in Section 10(b) of the Securities Exchange Act of 1934, and has required that the injury suffered by an investor as a result of a defendant's deceptive practices "touch" the purchase or sale of the securities in issue. *Superintendent of Insurance v. Bankers Life and Casualty Company*, 404 U.S. 6, 12-13 (1971). Section 10(b) must,

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separate interrogatory on loss causation specifically. Indeed, when the district court, on at least two occasions, instructed the jury that affirmative answers to special interrogatories 1-3 would constitute a Rule 10b-5 violation and would then require the jury to determine what damages flow from that violation in accordance with the district court's instructions, Ernst & Whinney stood silent.

however, be read "flexibly, not technically and restrictively." *Id.* In this regard, the Second, Third and Fifth Circuits are all in agreement that the misrepresentation or omission must have caused, in some direct or proximate way, the plaintiff's pecuniary loss.[15]

Applying these standards, the courts have found the required causal connection between the misrepresentation and the harm incurred not only where there has been deception impacting upon the value of the security, but also in situations involving deception with regard to the course of dealing in the securities, or for failing to advise of the risks inherent in buying certain securities. *Manufacturers Hanover Trust, supra; SEC v. Drysdale, supra; Angelastro, supra; A.T. Brod & Co. v. Perlow,* 375 F.2d 393 (3d Cir. 1967); *In Re Catanella, supra.*

Yet, in this case, the material misrepresentations by Ernst & Whinney directly touched upon the value of the security. If Ernst & Whinney had done a proper audit in accordance with GAAS, the Jackson Co. financial statements would not only have reflected a significantly different financial picture, but Ernst & Whinney most likely would have issued a different opinion.[16] This matter is

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[15] *See Manufacturer's Hanover Trust Company v. Drysdale Securities Corp.,* 801 F.2d 13 (2d Cir. 1986); *cert. denied,* 479 U.S. 1066 (1987); *SEC v. Drysdale Securities Corp.,* 785 F.2d 38 (2d Cir.), *cert. denied,* 476 U.S. 1171 (1986); *Angelastro v. Prudential-Bache Securities, Inc.,* 764 F.2d 939, 942-43 (3d Cir.), *cert. denied* 474 U.S. 935 (1985); *Huddleston v. Herman & MacLean,* 640 F.2d 534 (5th Cir. 1981), *aff'd in part, rev'd in part on other grounds,* 459 U.S. 375 (1983); *Healey v. Catalyst Recovery of Pennsylvania, Inc.,* 616 F.2d 641 (3d Cir. 1980); *Schlick v. Penn-Dixie Cement Corp.,* 507 F.2d 374 (2d Cir. 1974), *cert. denied,* 421 U.S. 976 (1975); *In re Catanella and E.F. Hutton and Company, Inc. Securities Litigation,* 583 F. Supp. 1388 (E.D. Pa. 1984).

[16] Ernst & Whinney could have issued an "adverse opinion" which is given when an auditor determines that the client

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not simply a case of "but for" Ernst & Whinney's misrepresentations and non-disclosures, Bradford-White would not have purchased Jackson Co.'s stock. Rather it was Ernst & Whinney's misrepresentations and non-disclosures in its opinion upon which Bradford-White relied in determining to purchase Jackson Co., how to structure the stock acquisition, what to pay for the stock, and the extent to which it would guarantee various liabilities. (E&W App. 54-56, 73-77) The direct correlation between Ernst & Whinney's misstatements and omissions, and Bradford-White's actions in reliance thereon, establish the "touching" or loss causation requirement for a 10b-5 action.

The purpose of engaging an independent auditor to perform a GAAS audit on a company's financial statements is to obtain a certified opinion on the fairness of the company's financial position, results of operations, and changes in financial position *based upon an audit conducted in accordance with certain professional standards* so that all information is uncovered to present a complete picture of the company's financial condition. This, Ernst & Whinney's audit failed to do, despite an affirmative representation to the contrary. The satisfaction of this loss causation requirement[17] for 10b-5 liability is established on the face of Ernst & Whinney's

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has materially misstated certain items on its financial statements, or a "disclaimer opinion," which is generally issued when the auditor lacks sufficient information to give an overall opinion as to the financial statements. *United States v. Arthur Young & Co.*, 465 U.S. 805, 818-19 n. 13, *cert. denied*, 466 U.S. 936 (1984).

[17] Even if Ernst & Whinney were correct that the factual basis for the element of "loss causation" was not submitted to the jury in the special interrogatories, Ernst & Whinney has no foundation from which to launch a complaint:

> When a fact question is not submitted to the jury, "each party waives his right to a trial by jury of the

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own audits which dramatizes an inexplicable change in the net worth of the Jackson Co. from December 1980 to June 1981 of over five million dollars, which reflected a negative swing of approximately 400 percent in the Jackson Co.'s net worth in six months due only to the quality of the audits performed by Ernst & Whinney. This is exactly what the Court of Appeals recognized when it rejected Ernst & Whinney's "interpretation" of what the jury had done. (E&W App. 19-20)

Thus, Ernst & Whinney's allegations of a split between the Third and the Fifth Circuits on the requirement of loss causation is mere whimsy on its part, created solely for jurisdictional purposes, since the law as applied by these Circuits is not only complimentary, but was also consistently applied by the Court of Appeals in reconciling the jury's answers to special interrogatories.

D. The Court of Appeals Adopted A View of This Case Which Rationally Reconciles the Jury's Overwhelming Findings of Fact in Bradford-White's Favor with the Finding of "Fair Presentation."

As required by the Seventh Amendment and the decisions of this Court, the Court of Appeals was bound to adopt a view of the case which rendered the jury's answers to special interrogatories consistent. *Atlantic and Gulf Stevedores, Inc. v. Ellerman Lines, Ltd.*, 369 U.S. 355, 358-59, 363 (1962); (E&W App. 20-23) Ernst & Whinney does not dispute this standard of review for the jury's

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> [fact] issue so omitted unless before the jury retires he demands its submission to the jury". *Huddleston v. MacLean*, 640 F.2d 534, 550 (5th Cir. 1981), *rev'd in part on other grounds*, 459 U.S. 375 (1983).

Of course, in this case, the district court properly charged on loss causation and the jury properly found that the damages flowed from the 10b-5 violation.

answers. What Ernst & Whinney does object to is the Court of Appeals' interpretation and reconciliation of the answers. In other words, Ernst & Whinney is seeking this Court's opinion on whether the jury's answers to special interrogatories are consistent. This, however, is not a basis for the granting of a writ of certiorari, pursuant to Supreme Court Rule 17.1. (*See*, note 6, *supra*).

As the district court readily noted in denying Ernst & Whinney's Motion for JNOV, Bradford-White presented sufficient evidence at trial to support a 10b-5 claim, and the jury's findings of fact in answers to special interrogatories 1(f), 2 and 3 established all the elements of a 10b-5 claim. (E&W App. 73) The district court, however, was troubled with what it perceived as an apparent inconsistency in the jury's findings of fact in special interrogatory 1. (E&W App. 82-83) The jury found that there were material misrepresentations and/or omissions with respect to inventory, product warranty liability, net worth, net income (loss), and the performance of an audit in accordance with generally accepted auditing standards. (E&W App. 27) Nevertheless, the jury also found no material misrepresentation or omission regarding the financial statements' presentation in accordance with GAAP. (E&W App. 28) On the sole basis of this alleged inconsistency in the jury's answers to the subparts of Interrogatory 1, the district court granted Ernst & Whinney's motion for a new trial on the federal securities claim.[18] (E&W App. 82-83) On review, the Court of Appeals, however, found no difficulty in harmonizing the answers to special interrogatories and reversed the district court's grant of new trial. (E&W App. 18-23)

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[18] The district court erroneously agreed with Ernst & Whinney that there was an irreconcilable inconsistency despite the fact that both in its charge to the jury and the special interrogatory instructions, the jury was told that answers in the affirmative to *any* one of the subparts of Interrogatory 1, and Interrogatories 2 and 3 would be sufficient to find a Rule 10b-5 violation. (E&W App. 27-29; B-W App. 18-20, 22, 30)

Ernst & Whinney alleges now that the "fair presentation" finding by the jury, (Interrogatory 1(g)), is a "complete defense" to 10b-5 liability, and that the Court of Appeals, in reconciling the answers, somehow dismissed the jury's finding 1(g). (Petition of Ernst & Whinney, at 21) The Court of Appeals did not dismiss this finding, but rather, reviewing *all* of the jury's answers in light of the district court's instructions and the evidence at trial, adopted a logical and probable view of the jury's answers to implement the obvious intent of the jury. The Court of Appeals' decision does not blanketly hold that fair presentation is never a defense, nor that some standard other than fair presentation is necessary to avoid 10b-5 liability. It merely held that, on the basis of the instructions to the jury and the facts found by the jury, *in this case*, Ernst & Whinney's *"presentation* of the incomplete data it had obtained as a result of the defective audit . . . in no way undermined [the jury's] answers to the other questions." (E&W App. 22, footnote omitted)(emphasis in original).

No matter how Ernst & Whinney wishes to dissect the Court of Appeals' opinion in an attempt to create a jurisdictional basis for the granting of a writ of certiorari, this case simply does not present "an important question of federal law which has not been, but should be, settled by this Court, or . . . a federal question [which has been decided] in a way in conflict with applicable decisions of this Court." Sup. Ct. R. 17.1(c). Indeed, Ernst & Whinney's Petition should be denied because this case is so fact specific that it can have little application generally, and will not significantly advance or clarify the law for federal securities claims.

II. THE COURT OF APPEALS DID NOT RULE, AS A MATTER OF LAW, THAT A STATUTE OF LIMITATIONS DEFENSE CANNOT BE RAISED IN A TRIAL DE NOVO IF IT WAS NOT ASSERTED IN THE FIRST TRIAL.

The third "Question Presented for Review" by Ernst & Whinney in its Petition is not even argued by Ernst & Whinney in the text of its Petition, but is relegated to a footnote. (Petition of Ernst & Whinney, at 24 n.16) That placement of its entire argument on its third question for review was perhaps not an oversight by Ernst & Whinney, but rather a tactical decision made in recognition of the question's total lack of merit. The Court of Appeals did not even address the issue of whether the statute of limitations defense could be raised at a trial de novo, since it found that the grant of the new trial was erroneous and the only question was whether Ernst & Whinney had waived the defense during the course of the original trial, as found by the district court.

Upon reconciling the jury's answers to special interrogatories and finding that the judgment in favor of Bradford-White on its federal securities claim should be reinstated, the Court of Appeals then went on to affirm the district court's ruling that by the end of this jury trial, "Ernst & Whinney had waived any possible statute of limitations defense." (E&W App. 24, 65-66) Having waived the statute of limitations defense, Ernst & Whinney cannot in post trial proceedings and now at the appellate stage attempt to preclude the entry of judgment in accordance with the jury's answers to interrogatories on the basis of this affirmative defense.

During the post trial motion stage, Ernst & Whinney filed a motion arguing *for the first time* that Bradford-White's 10b-5 claim was barred by the statute of limitations. It is fundamental that a party cannot seek to disturb a judgment on the basis of a theory not argued prior to or at the time of trial. 11 Wright & Miller, *Federal Practice and Procedure* Para. 2805, at 40; *see also Henderson v. S.C. Loveland Co., Inc.*, 396 F. Supp. 658, 661 (N.D. Fla.

1975). Furthermore, there is no question but that Ernst & Whinney had the burden to plead and prove its defense that the claim of Bradford-White was barred by the applicable statute of limitations. (E&W App. 24); *see also* Fed. R. Civ. P. 8(c); 2A *Moore's Federal Practice* Para. 8.27[4] (2d ed. 1986); *Mumbower v. Calicott*, 526 F.2d 1183 (8th Cir. 1975). The issue of when the limitations period commenced, when Bradford-White knew or should have known of its claim against Ernst & Whinney, and whether the limitations period was in any way tolled, were all questions upon which evidence should have been presented, and which should have been decided by the fact-finder, i.e. the jury, if Ernst & Whinney was going to rely on that defense. *See Penturelli v. Spector Cohen Gadon & Rosen*, 640 F. Supp. 868, 872-73 n.1 (E.D. Pa. 1980); *see also* (E&W App. 25 n.8) Since Ernst & Whinney did not raise the issue prior to or during trial by motion, argument, presentation of evidence or request for instruction to the jury,[19] the defense was waived or abandoned. *See Barby v. Cabot Corporation*, 598 F. Supp. 407, 414 (W.D. Okla. 1983).

In ruling on Ernst & Whinney's post trial motion, the district court pointedly remarked and held: "I am not persuaded that Ernst & Whinney has timely raised the statute of limitations issue . . . Ernst & Whinney presents a new issue, not raised at trial, premised on a noncontrolling decision which was reported prior to trial. Therefore, I find that the statute of limitations issue is not

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[19] A review of the record indeed confirms that Ernst & Whinney never requested any instruction on the statute of limitations defense and made no objection when the trial court informed the jury that a bar of Bradford-White's claim on the basis of statute of limitations was not at issue in the suit. (B-W App. 25-28) By failing to object to the trial court's charge on the non-existence of a statute of limitations defense, Ernst & Whinney waived any such claim of error and the defense itself. Fed. R. Civ. P. 51; *Smith v. Bowater Steamship Co.*, 339 F. Supp. 399 (E.D. Pa. 1972).

preserved and is deemed to have been waived." (E&W App. 65-66)

This waiver of the statute of limitations defense was confirmed at oral argument before the Court of Appeals when counsel for Ernst & Whinney acknowledged "that a conscious, tactical decision had been made not to move for dismissal or for summary judgment on the limitations basis as such a motion would have somehow given credence to Bradford-White's claims, thus prejudicing Ernst & Whinney's defense on the merits." (E&W App. 24, footnote omitted) The Court of Appeals, thus, affirmed the district court's finding of waiver on this statute of limitations defense. Consequently, the propriety of ordering the reinstatement of judgment in Bradford-White's favor was not, and cannot be, affected by a statute of limitations defense which was only raised and pursued after judgment.

As noted above, the only argument Ernst & Whinney presents in its Petition pertaining to the statute of limitations is found in a footnote. In footnote 16, Ernst & Whinney confuses the district and appellate courts' rulings on the waiver of the statute of limitations as to the first trial, with the district court's grant of Ernst & Whinney's motion for summary judgment on a statute of limitations basis pending the second trial. Whether Ernst & Whinney could have asserted a valid statute of limitations defense if there was a trial de novo[20] was not a

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[20] Ernst & Whinney also appears to argue in footnote 16 that it was within the district court's discretion to permit the consideration of its statute of limitations defense during the post-trial motion stage. Bradford-White does not believe that this issue has been properly presented to this Court for review. Nevertheless, the cases which Ernst & Whinney relies upon do not support this proposition. For example, in *Zenith Radio Corp. v. Hazeltine Research, Inc.*, 401 U.S. 321 (1971), the district court made preliminary findings of fact and conclusions of law, and granted Hazeltine leave to assert limitations and release

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question decided by the Court of Appeals, nor is it a proper question for review by this Court. The Court of Appeals' discussion on the statute of limitations, and its waiver, pertained to Ernst & Whinney's failure to raise that affirmative defense at the first trial, and consequently, its inability to preclude the entry of judgment in Bradford-White's favor on the jury's answer to interrogatories on that basis.

Given that the Court of Appeals never addressed the issue of what defenses Ernst & Whinney could have asserted if there was a trial de novo, and that Ernst &

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defenses after the close of evidence, but before the entry of any judgment. *Id.*, at 323, 328-29 n.3. Moreover, on appeal this Court noted:

> On the assumption that the trial court did hold the defenses of limitations and release to have been waived, we cannot say that the judge abused his discretion or stressed too much the value of avoiding reopening a trial to litigate matters that [Hazeltine] had an opportunity, but neglected, to litigate. . . . It is quite possible that [Hazeltine] knew exactly what it was doing in not presenting this argument during trial and that it realized a need to present it only after it learned that its original arguments had not induced the court to hold in its favor.

Id., at 332-33. *See also Emich Motors Corp. v. General Motors Corp.*, 229 F.2d 714 (7th Cir. 1956) (*on remand* to the district court for a new trial, defendants were permitted to amend their answer to assert a newly-decided statute of limitations); *Riley v. MEBA Pension Trust*, 452 F. Supp. 117 (S.D.N.Y. 1978)(the defendant was allowed to raise a defense *on remand* that it had not previously raised). These cases have no application to Ernst & Whinney's assertion that the district court could, in its discretion, have permitted invocation of the statute of limitations defense in deciding the post-trial motions. In any event, the district court *did not* permit the late assertion of the defense, as it determined that it had been waived.

Whinney does not present any question or argument as to whether the district court and the Court of Appeals erred in finding that it had waived its statute of limitations defense at the first trial, there is no question presented for this Court's review which falls within Supreme Court Rule 17.1.

III. CONCLUSION

Based on the foregoing, it is respectfully requested that Ernst & Whinney's Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit be denied.

Respectfully submitted,

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Dated: November 13, 1989

APPENDIX

IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

BRADFORD WHITE CORPORATION — CIVIL ACTION

V.

ERNST & WHINNEY — NO. 83-3371

Philadelphia, Pennsylvania
July 25, 1986

BEFORE: THE HONORABLE JOSEPH L. MC GLYNN, JR., J.
And a Jury

TRIAL - DAY TWELVE [sic]

CHARGE OF THE COURT/VERDICT

* * *

(p. 22) Jury. Let's take a short recess.

(Brief recess.).

CHARGE OF THE COURT

(The jury entered the courtroom.)

THE COURT: Good morning. Sorry to keep you waiting. We had some technicalities to go over. I think we are prepared to proceed now.

I am going to instruct you now with respect to the law and it is going to be your job as jurors to arrive at a verdict. You are the fact finders. You determine what the facts are, then you apply the law and I give you to the fact [sic] as you find them.

In order to assist you in deciding the facts I have prepared a series of questions which you, by responding

to these questions, will give me the information which would allow me to mold the verdict.

I will explain this to you as we go along. I think it will be of some assistance to you, because there are some various theories of law which are presented and in order to avoid confusing them, I made this road map for you in a sense.

Now, it is your duty as jurors to follow the law stated by me and to reach a just verdict, regardless of the consequences in this case, and apply the rules of law as you find them to the facts, to the facts as you find them. You (p. 23) are not to single out one instruction as stated in the law, but must consider the instructions as a whole.

You are not to be concerned with the wisdom of any rule of law stated by me, regardless of any opinion you may have as to what the law ought to be. It would be a violation of your duty to base a verdict on any other view of the law than that given in this these instructions.

Justice through trial by jury must always depend on the willingness of each individual juror to seek the truth as to the facts from the same evidence presented to all the jurors; and to arrive at a verdict by applying the same rules of law.

You are to perform your duty without bias or prejudice as to any party. Our system of law does not permit jurors to be governed by sympathy, prejudice or public opinion. Both the parties and the public expect that you will careful [sic] and impartially consider all of the evidence in the case, follow the law as stated by me, and reach a just verdict.

All persons stand equal before the law. You are to treat Bradford-White and Ernst & Whinney as equals. And the law is no respector [sic] of persons. They all stand the same, rich or poor. So, when you are considering the evidence, again you don't let your natural predilictions of compassion or understanding sway your judgment. You base your verdict (p. 24) upon the evidence. You give a clinical objective look. You will not be governed by things which have no place in arriving at a decision or arriving at the truth as to the facts in the case.

Now, as I instructed you earlier, mentioned you to have early, the burden is on the plaintiff in a civil action such as this, to prove its case by a preponderance of the evidence.

I am sure you understand the plaintiff in this case is Bradford-White. The defendant is Ernst & Whinney. So that the plaintiff, Bradford-White, has the burden of proving its case by what we call a preponderance of the evidence. If the proof should fail to establish any essential element of the claim by a preponderance of the evidence, then you should find for the defendant, Ernst & Whinney.

To establish by a preponderance of the evidence means to prove that something is more likely so than not so. In other words, a preponderance of the evidence in the case means such evidence as when considered and compared with that opposed to it, has more convincing force, and produces in your minds belief that is what is sought to be proved is more likely true than not true.

Now it has often been described as weighing the evidence. If you can conjure up in your mind the picture

of (p. 25) two scales, balance scales, evenly balanced. And the evidence is piled for one side on one scale, one tray; the evidence for the other side in the other tray. If they remain equally balanced or if they tip in favor of the defendant in those two instances, you should find in favor of the defendant.

On the other hand, if it tips in favor of the defendant, no matter how slight, you should find in favor of the plaintiff. That is what we mean when talking about the burden of proof and the preponderance of the evidence.

In determining whether any fact in issue has been proved by a preponderance of the evidence, you consider the testimony of the witnesses, regardless of who may have called them, and all the exhibits which have been received into evidence, regardless of who may have produced them.

You should also consider the responses that the parties made to interrogatories and any stipulations of the facts made.

Now in your consideration of the evidence you are not limited to the bald statements of the witnesses. You are free to give your own experience, to bring your own experience into play. In other words, you don't leave your common sense behind, although you must take the evidence as you heard it in the courtroom. When you go back to the jury room, you don't leave your common sense behind. You can put (p. 26) your common sense to work in determining just what the facts are.

In other words, you are not limited solely to what you see and hear as the witnesses testify. You are permitted to draw from facts which have been proved such reasonable inferences as seem justified in the light of your own experience.

There are generally two types of evidence from which a jury may properly find the truth as to the facts of the case. One is direct evidence such as the testimony of an eyewitness. The other is indirect or circumstantial evidence, that is the proof of a chain of circumstances pointing to the existence or nonexistence of certain facts.

As a general rule the law makes no distinction between direct and circumstantial evidence, but simply requires that the jury find the facts in accordance with the preponderance of the evidence, of all the evidence in the case, both direct and circumstantial.

Now, one of the issues you will have to contend with is the issue of credibility. That is the believability of a witness, whether the witness is telling the truth and the weight to be given to the testimony of the individual witnesses.

Now you the jury, are the sole judges of the credibility of the witnesses and the weight their testimony (p. 27) deserves. You may be guided by the appearance and the conduct of the witness, the manner in which the witness testifies, the character of the testimony given. You should carefully scrutinize all the testimony, the circumstances under which each witness has testified, every matter in evidence which tends to show whether a witness is worthy of belief.

Consider each witness' intelligence, motive and state of mind. Consider the witness' demeanor and manner while on the witness stand. Consider the witness' ability to observe the matters to which he or she has testified or whether he or she impresses you as having an accurate recollection of those matters. Consider also any relation each witness may bear to either side of the case; the manner in which each witness may be affected by the verdict, and the extent to which, if at all, each witness is either supported or contradicted by other evidence in the case.

Inconsistencies or discrepancies in the testimony of a witness, or between the testimony of different witnesses may or may not cause you to discredit such testimony.

Two or more persons witnessing an incident or transaction may see or hear it differently; and innocent misrecollection like failure of recollection is not an uncommon experience. In weighing the effect of a (p. 28) discrepancy, always consider whether it pertains to the matter of importance or an unimportant detail, and whether the discrepancy results from innocent error or intentional falsehood.

After making your own judgment, give the testimony of each witness such weight, if any, that you think it deserves.

You have heard in this case a number of witnesses who we can identify as expert witnesses. Witnesses who by education or experience have become skilled at some art or science or profession are permitted to state opinions as to relevant matters in which they are expert. They may also state the reasons for that opinion.

You should consider the expert opinion received into evidence in the case and give it such weight as you think it deserves. If you should decide that the opinion of the expert witness is not based upon sufficient education and experience, or if you should decide that the reasons given in support of the opinion which they expressed, are not sound, or if you feel that the opinion is outweighed by other evidence, you may disregard the opinion entirely.

In resolving any conflicts that may exist in the testimony of expert witnesses, you are entitled to weigh the opinion of one expert against that of another. In doing this you should consider the relative qualifications and (p. 29) reliability of the expert witnesses, as well as the reasons for each opinion and the facts and other matters upon which that opinion was based.

Now this case involves a purchase of stock of W. L. Jackson Manufacturing Company. I instruct you as a matter of law on the evidence which has been introduced in this case, the interest in the Jackson Company purchased by the plaintiff is what we call a security, within the meaning of the Federal Security [sic] laws.

Now the plaintiff in this case, Bradford-White, has brought this action. One of the theories of liability is the Federal securities laws, particularly, the Securities and Exchange Act from 1934.

In accordance with the authority granted under this Act, the United States Securities and Exchange Commission has adopted a rule known as Rule 10(b) (5) which has the force of law.

Now the plaintiff contends that the defendant Ernst & Whinney has violated 10(b)(5) of the Securities and Exchange Commission. This rule states that it is unlawful for any person to defraud another person in connection with the purchase or sale of securities.

Specifically paragraph two that the rule makes it is unlawful to make any untrue statement of a material fact in connection with securities trading. It also makes it (p. 30) unlawful to fail to state a material fact, if that fact is necessary under the circumstances to make the statements that were made not misleading.

Now, to recover damages, from the defendant for violation of paragraph two of rule 10(b)(5), plaintiff must prove each of the following five things by a preponderance of the evidence:

First, that the defendant made an untrue statement of a material fact or that he failed to state a material fact necessary, to keep the statements that were made from being misleading under the circumstances.

Secondly, that the defendant acted knowingly.

Third, that the defendant used the mail or telephone in connection with the statements which were made.

Fourth, that the plaintiff reasonably relied on that defendant's untrue or misleading statements or the failure of the defendant to state a material fact.

Five, that the plaintiff suffered damages as a result.

Now, in deciding whether misrepresentations or omissions, you must decide whether plaintiff has proved by a preponderance of the evidence that the defendant

either made untrue statements of a material fact in connection with the stock transaction, or that he failed to disclose a material (p. 31) fact that would have prevented statements that were made from being misleading.

Whether a statement is true or not depends on the facts as they existed at the time the statement was made, not the facts as they appear now with the benefit of hindsight.

A statement of fact is a transmission of information. A fact stated or omitted is material if a reasonable investor would consider it important to the decision whether or not to buy or sell a particular security or stock. Now, a statement of fact should not be confused with the expression of opinion such as recommendation or forecast. These latter sort of statements may be the basis for liability issue, not because they are proved wrong but only if you find they were made without a factual basis by someone who held himself out as an expert.

Now to prove the second part of misrepresentation under rule 10(b)(5), plaintiff must prove by a preponderance of the evidence that Ernst & Whinney made the untrue statement or omitted necessary clarifying information either:

One, with the knowledge that the statement was false: or that the omission would make a statement false or misleading.

Two, with reckless indifference as to whether or (p. 32) not it was true. Recklessness may exist when a defendant has reason to know of a material misstatement or

omission, but fails to cure it though it could have done so without great effort.

It is not enough for a violation of section 10(b)(5) that the defendant was simply careless or negligent.

Now because you cannot know what a person is thinking, you must determine the knowledge of the falsity by considering the evidence of the defendant's actions and words in the light of all of the surrounding circumstances at the time.

Now to prove the fourth element of the 10(b)(5) violation, the plaintiff must prove by a preponderance of the evidence that he relied on the false statement or misleading omission, in deciding to buy or sell the Jackson Company, and that he was justified in relying upon it. That it was reasonable for him to rely on these statements.

The law does not impose liability for fraud simply because a person was led to make an investment that may have turned out to have been unprofitable or unwise.

To find for the plaintiff you must find he relied, Brandford-White relied on untruthful statements or omissions.

Finally, for plaintiff to recover for misrepresentations or omissions by the defendant, plaintiff (p. 33) must show he has suffered damages as a result of his reliance on the defendant's fraud.

If you find that plaintiff would not have traded in this security stock but for the material misrepresentations, you may award any resulting loss suffered. You should compare the value of what the plaintiff got with

the value of what he gave up by trading in reliance on the misrepresentations or omissions; any incidental out of pocket costs plaintiff incurred as a result of relying on the misrepresentations or omissions should also be included, in the damages.

Another theory of liability suggested by the plaintiff in this case is the theory of negligence. Negligence is simply the failure to exercise ordinary care is the doing of some act which a reasonably prudent person would not do, or the failure to do something which a reasonably prudent person would do under the circumstances similar to those shown by the evidence.

In performing professional services for a client, an accountant has a duty to have that learning and skill ordinarily possessed by reputable accountants practicing in the same or similar locality under the same or similar circumstances. It is his duty the use the care and skill ordinarily used in like cases by reputable members of his profession practicing in the same or similar locality under (p. 34) similar circumstances to use reasonable diligence and his best judgment in the exercise of his professional skill in the application of his learning in an effort to accomplish the purpose for which are [sic] he was employed.

A failure to perform any such duty is negligence. Now an accountant is not negligent merely because he makes a mistake in the matter for which he is engaged. An independent auditor works by selective testing on the financial records of the company being audited.

There is the inherent risk that being a material misstatement in the record may not be discovered. The fact

that a material misstatement is discovered, is not in itself proof that the auditor was negligent in performing the audit. However if the accountant was negligent as defined in these instructions, it is not a defense that he did the best that he could.

Now if you find that Ernst & Whinney was negligent, and you must determine whether the defendant's negligence was a substantial factor in bringing about the plaintiff's damages. A substantial factor is an actual, real factor, although the result may be unusual. A substantial factor would, of course, be the reliance on the conduct of the auditor. If the auditor is negligent, and Bradford-White relied to their detriment on the conduct of Ernst & Whinney, then they are entitled to recover under the (p. 35) negligence theory.

There is also another factor which you can take into consideration in determining whether or not to award damages on the negligence theory. The plaintiff cannot recover if you determine that the Bradford-White themselves were guilty of negligence which proximately contributed to the loss which they sustained.

Negligence however slight of the plaintiff will be sufficient to bar a verdict in favor of the plaintiff provided his negligence is a proximate cause, that is a substantial factor in bringing about his own injury, Bradford-White's own injury.

On the other hand, the contributory negligence of a plaintiff will not bar a recovery for the injury sustained by Bradford-White if Ernst's & Whinney conduct was wanton or willful. Willful or wanton misconduct is intentional, wrongful conduct done either with knowledge

that serious injury to another will probably result or with a wanton reckless disregard of the possible results.

Further qualifications on the negligence theory, if the negligence of Bradford-White is remote, that is too far removed as to time and place or causative force to be a direct or proximate cause of the accident. In that case you would reduce the recovery, which you would otherwise award and apportion portion to Bradford-White's contribution to (p. 36) its own loss.

Now there is another theory, which plaintiff puts forward. That is for want of a better description, what I would call negligent misrepresentation.

In order to recover under that, the plaintiff must prove by a preponderance of the evidence: That Ernst & Whinney made a representation as to a past or existing material fact.

That the representation must have been untrue.

Three, that regardless of his actual belief the defendant must have made the representation without any reasonable ground for believing it to be true.

Fourth, that the representation must have been made with the intent to induce the plaintiff to rely upon it.

Five, that the plaintiff must have been unaware of the falsity of the representation. He must have acted in reliance upon the truth of the representation and he must have been justified in relying upon the representation.

Finally, as a result of his reliance upon the truth of the representation, the plaintiff must have sustained damage.

There is another theory upon which the plaintiff relies, it is called intentional misrepresentation. In order to prove an intentional misrepresentation, let me (p. 37) state it at this time the burden of proof with respect to this is somewhat different than the ordinary preponderance of the evidence.

The burden of proof of intentional fraud under the Tennessee law, involves proof by clear and satisfying evidence. That evidence must show that the defendant made a representation as to a past or existing fact, that the representation must be false, that the defendant must have known that the representation was false when he made it, or that he made it made [sic] the representation recklessly without knowing whether it was true or false. That the defendant made the representation with an intent to defraud the plaintiff, that is he must have made the representation for the purpose of inducing the plaintiff to rely upon it, to act or refrain from acting in reliance thereon.

The plaintiff must have been unaware of the falsity of the representation. He must have acted in reliance upon the truth of the representation. And he must have been justified in relying upon the representation.

Finally, as a result the plaintiff must prove that as a result of his reliance on the truth of the representation, he sustained damage. That is a little different from negligent misrepresentation.

Under negligent misrepresentation the representation must be made with the intent to induce (p. 38) plaintiff to rely upon it and the intentional misrepresentation deals

with the situation where the representation was made with intent to defraud the plaintiff.

Ordinarily the expressions of opinions are not treated as representations of fact upon which to base an actionable fraud. However when one party possesses or holds himself out as possessing superior knowledge or special information, regarding the subject of a representation, and the other party is so situated that he may reasonably rely upon such supposed superior knowledge or special information, a representation made by the party possessing such knowledge or information will be treated as a representation of fact, although if made by any other person might be regarded as an expression of opinion.

A party claiming to have been defrauded by false representation must have relied upon the representation, that is a representation must have been a proximate cause of his conduct in entering into the transaction and without such representation he would not have entered into the transaction.

The fraud if any, need not be sole proximate cause if it appears that reliance upon the representation substantially influenced such party's action, even though other influences operated as well.

(p. 39) Reliance upon a representation may be shown by direct evidence or may be inferred from the circumstances.

A party claiming to have been defrauded by a false representation must not only have acted in reliance thereon, but have been justified in such reliance. That is

the situation must have been such as to make it reasonable for him in the light of the circumstances and his intelligence, experience and knowledge, to accept the representation without making an independent inquiry or investigation.

If a party claiming to have been defrauded makes an independent investigation of the subject matter of the alleged false representation, and his decision to engage in the transaction is the result of his independent investigation, and not his reliance upon the representation he is not entitled to recover.

The fraudulent misrepresentations need not have been communicated directly. Since representations made to a third party knowing that it will be repeated to another for purposes of influencing conduct, subjects the maker of the representation to liability.

Ernst & Whinney is an independent accountant. They have expressed an opinion concerning the condition of the books and records of the W. L. Jackson Company. But Ernst & Whinney is not an insurer of Jackson's financial statements and did not guarantee the truthfulness of the (p. 40) representations contained in Jackson's financial statements.

You cannot find that Ernst & Whinney committed a fraud unless Bradford-White proves by a preponderance of the evidence that Ernst & Whinney lacked an honest belief that the statements made by it respect were [sic].

If Ernst & Whinney did act with an honest belief whether reasonable or unreasonable, it is not liability under the Securities laws for fraud.

If under the Court's instruction you find Bradford-White is entitled to a verdict against Ernst & Whinney, you must then award Bradford-White damages if which were proximately caused by the wrong upon which you base your finding of liability.

You heard the testimony concerning the amount that they paid for the stock. You have heard testimony concerning the out of pocket expenses. You are going to have to determine whether those damages are properly accessible. If you find indeed that the plaintiff is entitled to a verdict, damages must be proved just like liability must be proved and damages must be reasonable, and can't be used to punish the defendant. They must be reasonable. They are meant for compensation and for no other reason.

Also, it would be whatever damages they sustain (p. 41) less whatever benefits they derived. If they have derived a benefit, you find from the evidence they did derive some benefit, and you feel Bradford-White is entitled to some damages, you should make an adjustment for the benefit which they did derive from the transaction.

One thing, there are some discussions with respect to the taxes, talking about the NOL, net operating loss, how it could be used by Bradford-White in the purchase of the W. L. Jackson Company. You may take into consideration that aspect or those facts, in deciding whether or not there was reliance on this statement, whether or not they made this deal for reasons other than what was contained in this statement. But, if you get to the point of awarding damages, then you need not consider the fact that they

could have obtained a tax benefit, because the evidence does not show in fact they did obtain the tax benefit.

I want to make that clear, that evidence came in, to show you there was another reason for, another motive or ground for buying W. L. Jackson which would be of benefit to Bradford-White, other than its financial condition.

So you can take that into consideration in determining the issue of liability. But when you come to determine damages you may not take into consideration they obtained a tax benefit, because the record shows as it turned out, they did not take advantage of it.

(p. 42) The mere fact that I have instructed you regarding the measure of damages is not to be taken by you as an indication that I believe one side or the other is entitled to your verdict.

Instructions regarding the measure of damages are for your benefit, in the event that you do decide that Bradford-White is entitled to your verdict in this case.

If you find that there is no liability, then you may disregard, you will disregard the instructions concerning the plaintiff's damages.

Now, as I mentioned earlier I prepared a series of questions. I am going to go over them with you. Hopefully you will be able to understand them and follow the instructions. By responding to these interrogatories you will be giving us your verdict.

Now the first question says: Do you find by a preponderance of the evidence that defendant Ernst &

Whinney in connection with its audit or opinion concerning the December 31, 1980 consolidated financial statements of the W. L. Jackson Manufacturing Company, made a material misrepresentation or a material omission with respect to any of the following:

Now material representation or material omission have been defined to you in my instructions. You would apply those definitions when you go over the list of items (p. 43) here. I have listed a series of items:

Inventory, accounts receivable, product warranty liability, net worth, net income or loss, that Ernst & Whinney conducted its audit in accordance with generally accepted auditing standards, that the financial statements taken as a whole as qualified by the opinion of Ernst & Whinney presented fairly the financial position of the W. L. Jackson Manufacturing Company in accordance with the generally accepted accounting principles.

With each one of the questions you just check it off. Then it says:

If you have answered yes to one or more of the above items, then you would go to question two. If you have answered no to each of the above, proceed directly to question six. Question six deals with the negligence. If you answer no to each one of those items, then you have determined there would be no violation of the Securities law, Securities and Exchange Rule 10(b) (5).

If you find, if you answered yes to one or more of the above go to question number two. Question two: Do you find by a preponderance of the evidence that any of the representations or omissions were made either (1) with

knowledge that the statement was false or misleading; or (2), with reckless indifference as to whether or not it was true.

(p. 44) Now if you answer yes, identify which one of those items by their letter, which ones were made with knowledge that it was false or misleading or with reckless indifference. If your answer is yes, you identify that one which you say was so made. But if you answer no, you again would proceed directly to number six. If you answer no, that it wasn't done with the knowledge or it done [sic] with reckless indifference then you find in favor of Ernst & Whinney on the Securities Rule 10(b) (5) theory of liability.

If you answer yes then you proceed to three:

With regard to those items identified in your response to question 2, do you find by a preponderance of the evidence that Bradford-White (1) relied on the false statement or misleading omission in deciding to buy the stock of the W. L. Jackson Company; and (2), that it was reasonable to so rely.

In other words, to rely on the false statements and (2) that it was reasonable for them to rely. Okay, if your answer is yes, you identify by the letter used above which item or items. Then proceed to question four.

If your answer is no as to each item proceed directly to question six. If your answer is no again you will decide that that element or requirement of the security violation has not been proven by the plaintiff, therefore, (p. 45) the defendant would be entitled to a verdict on that count.

Then you would proceed to consider the negligence count.

If your answer is yes, you go to four:

Were the representations by Ernst & Whinney made without any reasonable ground for believing it to be true and with the intent to induce others to rely on it. Theory involving negligent misrepresentation.

There again you would be answering it yes or no, go on to the next question:

Intentional misrepresentation: Were the representations by Ernst & Whinney made with the intent to defraud others. Now your answers to those questions will determine whether or not, yes answer to question four will mean that the plaintiff as to the negligent misrepresentation count, would prevail. No answer would mean that Ernst & Whinney prevailed. Your yes answer to question five will show that the Bradford-White prevails on the intentional misrepresentation count, and no answer would mean that the Bradford-White -- would mean that Ernst & Whinney would prevail on the intentional misrepresentation count.

Then you would go on to six: Do you find by a preponderance of the evidence that Ernst & Whinney failed to use the care and skill ordinarily used in like cases by reputable members of the accounting profession practicing in (p. 46) the same or a similar locality, under similar circumstances. That is for the negligent count. There again yes or no. Yes, you proceed, would mean a finding in favor of Bradford-White; no in favor of Ernst & Whinney. If your answer is yes, you go on to the next

question. If your answer is no, and you have answered no to questions one, two or three, you do not go any further. In other words you have decided there is no liability, there is no liability with respect to the 10(b) (5) counts and there is no liability with respect to the negligence count and the misrepresentation count.

Now on the other hand if your answer is no, if you have answered yes, to questions one, two and three, then you go directly to number ten. That means you found that there was violation of 10(b) (5), but you find that there was no negligence involved, then you would go and award damages under question ten.

Now seven: Did Ernst & Whinney's failure as described in question six lead to a material misrepresentation or a material omission upon which Bradford-White relied. Well this is like proximate cause, whether or not, even though there was negligent misrepresentation, they were negligent in the conduct of the audit, if that, only if that led to a material misrepresentation or a material omission could you find (p. 47) liability and impose liability on Ernst & Whinney. So that a yes answer to that would mean yes you would find liability in favor -- you would find in favor of Bradford-White. Answer no would find in favor of Ernst & Whinney.

Then, if your answer is yes, you proceed to question number eight. If your answer is no, you have to answer -- you have answered no to questions one, two or three, do not proceed any further. I have already explained that. If your answer was no, and you have answered yes to questions one, two and three you would proceed to question number ten.

Question number eight: Was Bradford-White contributorily negligent. Was there any conduct on their part, which contributed to the [sic] their own losses. That is whether or not they failed to exercise reasonable care under the circumstances. And if they failed to exercise reasonable care under the circumstances, then they are guilty of what we call contributory negligence.

And if you find they are contributorily negligent then that would bar their recovery under the negligence theory provided that the conduct of Ernst & Whinney was not wanton or willful. And if there is a ques [sic] in here: If you find Bradford-White's negligence is too far removed as to time or place or causative force to be a direct or proximate cause of the injury, then you would answer yes, in that (p. 48) case, you could answer yes, or no, in this case if it was too remote. You only deduct the amount, the proportionate amount by which Bradford-White's own conduct contributed to the [sic] their losses. If you have answered yes if your answer is yes to the remoteness you proceed to question number ten. If your answer is no, and you answered no to one, two or three do not proceed any further.

Question ten: In what amount do you award damages. Put a one figure amount in there as to the losses you find that Bradford-White has sustained.

Then there is another question: Proceed to question eleven, only if you have answered yes to question nine. State the amount by which the damages should be reduced to reflect Bradford-White's proportional contribution to the damages. What their own conduct caused, losses their own conduct caused.

And what I will do if you answer question 11, then I will deduct the amount you put in there from the amount you state in response to question ten.

Now I hope you will be able to follow it. Let me say, we have ordered lunch for you. This is an important case, as you can well imagine, to both plaintiff and the defendant. We want you to give it the care and time, the attention that it should have. No one should feel you are under any time constraints. You should understand if around (p. 49) five clock [sic], if you have not agreed on your verdict, I will call you in and ask you at that time whether you wish to continue to deliberate further today, or whether you wish to come back on Monday and continue your deliberations. So you will understand that there is no time constraint on the verdict.

You will be permitted to go home even though you are deliberating.

Now finally, the verdict must represent the considered judgment of each juror. The response to each one of the questions must be your considered judgment. And you must all agree. In other words your verdict must be unanimous as to each one of these questions.

Your duty as jurors is to consult with one another and to deliberate with the view to reaching an agreement, if you can do so without violence to your individual judgment. You must each decide the case for yourself, only after an impartial consideration of the evidence in the case with your fellow jurors.

In the course of your deliberations do not hesitate to reexamine your own views, and change your opinion if

you are convinced it is erroneous. But do not surrender your honest conviction as to the effects or the weight of the evidence solely because of the opinion of your fellow jurors or for the mere purpose of returning a (p. 50) verdict.

Remember at all times, that you are the judges, you are the judges of the facts. Your sole interests is to seek the truth of the evidence in the case.

Now one final word, when you go out to begin your deliberations you will select from amongst yourselves the foreman or forelady, foreperson. He or she will preside over your deliberations, but I am sure you will understand his or her views are not entitled to any greater weight than the views of the other individual jurors.

May I see counsel up here.

(The following conference was held at the sidebar:

MR. KITTREDGE: Just for the record Your Honor, you yesterday said you were going to give my charge number 12. You did not. That is the language from the United States Supreme Court. I take exception.

THE COURT: I reconsidered that. I don't think it is necessary. I think all the points were covered in my charge.

MR. KITTREDGE: I take exception to the actual, your charge with respect to the time of filing this lawsuit is totally irrelevant to the deliberations.

THE COURT: Well I don't think it is totally irrelevant. I mentioned that to them, but I will also say that it is a factor that they can take into consideration. (p. 51) I

can't negate his argument that this is something that came along only when they found out it wasn't going to work out, so I will give you a charge, I will mention that.

MR. KITTREDGE: You also mentioned interrogatories and something else, you did not mention the admissions and the pleadings or admissions with respect to requests for admissions.

THE COURT: All right. I think they understood that, but I will comment.

MR. KITTREDGE: I take exception to Your Honor's charge about the tax benefits. My point is not the end result, which has to do with the argument to the jury that when they risked the million dollars they really were only risking half that amount because of the income tax bracket they were in. That was the charge. I also take exception to Your Honor's indicating it has to be a unanimous verdict. I thought we were doing the seven out of eight.

THE COURT: No, never.

MR. LEHANE: For the record we will take exception to the points handed up to Your Honor yesterday.

MR. KITTREDGE: I have that too.

MR. LEHANE: We object generally to the charge to negligence other than negligent misrepresentation charge that we discussed earlier today.

THE COURT: Go ahead.

(p. 52) MR. LEHANE: The only other thing I had going through the 10(b) 5 charge, you made reference to trade and security.

THE COURT: I know I did that, but I went back and said instead of -- I said purchase of the stock. I think they understand.

MR. LEHANE: They compare the value of what they got with the value of what they gave up. We talked yesterday about the fact there is no evidence in the record.

THE COURT: There is something in the record. They know what they got.

MR. LEHANE: I will take exception to that charge.

THE COURT: Okay.

MR. KITTREDGE: Question number ten should be also if they answered six yes, in other words that looks like you have to find 10(b) even if they don't find 10(b), they find negligence, still have to do 10.

THE COURT: Right.

(Discussion held off the record.)

MR. LEHANE: Since he brought this up, to preserve what I said earlier, my question, I think you covered in your explanation, but the questions don't say, seven deals with proximate cause.

MR. KITTREDGE: I thought you covered that in your charge.

(p. 53) THE COURT: I said it.

(End of sidebar conference.)

THE COURT: Ladies and gentlemen, counsel brought to my attention a couple of matters where I

either omitted to speak or misspoke. It wasn't willful or intentional I assure you.

Time there was an argument made by counsel that the time of the filing of suit has some significance. That was you can take that argument in consideration in deciding whether or not there is actual reliance by Bradford-White and all the other circumstances which you heard about.

But the fact that they filed suit when they did does not bar the proceeding as I am sure you understand that. I think usually the Statutes have what we call Statute of Limitations and you are required to bring suit within a certain number of years. I am not sure what it is in the case of a 10(b) (5), but you can bring an action all the way up until the time the Statute of limitations has run.

But that does not mean you cannot take that into consideration in determining whether or not there is reliance by Bradford-White on the Ernst & Whinney opinion which was of the December 1980 financial statements.

Also I mentioned that the evidence consisted of the testimony, exhibits, and the interrogatories that may (p. 54) have been read into the record, the stipulations of counsel. They have also included any admissions in the pleadings which I think were also read into the record.

I think that's it.

So, you have all the exhibits together.

(The jury left the Courtroom at 11:57 a.m.)

MR. KITTREDGE: Your Honor's pleasure for us?

THE COURT: Well, why don't you hang around for a few minutes. They might have immediate questions, might ask about exhibits or something like that, but when their lunch comes up you can go

(p. 55) (Jury Question).

THE COURT: You have seen this communique we have from the jury: The first question: With respect to question one, must the quote material misrepresentation or omission be intentional.

My response to that is they will reach the question of state of mind when they get to question number two, where it says, with knowledge that the statement was false or misleading or with reckless indifference of whether or not it was true. I will tell tell [sic] them they will reach that question when they get to question number two. This just deals with whether or not there were material incorrect or false statement [sic]. Two: Are questions one through five related just to Securities and Exchange regulations. The answer to that questions one through three are yes, four and five are a combination of intentional misrepresentation and negligent misrepresentation which will overlap the rest. Do you have any comments?

MR. DONLEY: No comment with the way Your Honor intends to handle it.

MR. DENWORTH: Overlaps?

THE COURT: Four and five deal with if they answer questions one, two, three you have a securities violation. Four and five is [sic] overlap to the extent that the same finding involving the one, two and three are applicable

with respect (p. 56) to four and five. One is the intentional misrepresentation; the other is negligent misrepresentation. Then six deals with simple negligence.

(The jury entered the Courtroom at 12:30 p.m.)

THE COURT: You may be seated ladies and gentlemen. I have your question. The first questions says: With respect to question number one, must the quote material misrepresentation or omission be intentional. You don't have to make that determination with respect to answering question number one. If you look at question number two, the state of mind necessary under that 10(b)(5) claim is set forth in number two.

Question number two. That gives you the state of mind. That is what we mean intentional. Two says: Do you find by a preponderance of the evidence that any of the representations or omissions were made either (1) with knowledge that the statement was false or misleading, knowledge that the statement was false or misleading or with reckless indifference as to whether or not it was true. That is the state of mind which was required under 10(b)(5).

So you will reach the answer to your question when you get to question number two. Then your second inquiry says: Are questions one through five related to the Securities and Exchange regulations ten B. Okay. Questions (p. 57) one through three deal specifically with the Securities and Exchange regulations 10(b)(5). If you find yes with respect to each one of those three questions, then you have found a violation of the Securities and Exchange. If your answer is no as to any of them, then that be won't be [sic] a violation of 10(b)(5). Do you follow me?

All right, now, questions four and five kind of overlap. But four and five deal specifically with the mental state necessary for what, I guess for want of a better term, that the State law claim of intentional misrepresentation and negligent misrepresentation. Four is negligent misrepresentation and five is intentional misrepresentation. That is the state of mind necessary for those, what we call State law claims.

They will overlap to a great extent the 10(b)(5). So your responses with respect to the 10(b)(5), the first three questions, will have some bearing on your answers to questions four and five. They will be related in the final analysis.

Anybody have any questions? Is that it? All right.

(The Jury left the Courtroom at 12:35 p.m.)

(p. 58)(VERDICT)

(The Jury [sic] the Courtroom at 4:50 p.m.)

DEPUTY CLERK: Members of the jury have you all agreed upon your verdict by answering the special interrogatories submitted by the Court.

THE JURY: Yes, we have.

DEPUTY CLERK: You may be seated. May I see it please?

I will read each interrogatory, then I will ask the Foreman for your answer to it. Number one, do you find by a preponderance of the evidence that defendant Ernst & Whinney in connection with its audit or opinion concerning the December 31, 1980 consolidated financial

statements of the W. L. Jackson Manufacturing Company made a material misrepresentation or a material omission with respect to any of the following.

DEPUTY CLERK: (a) inventory.

THE FOREMAN: Yes.

DEPUTY CLERK: (b) accounts receivable.

THE FOREMEN: No.

DEPUTY CLERK: (c) product warranty liability.

THE FOREMAN: Yes.

DEPUTY CLERK: (d) net worth.

THE FOREMAN: Yes.

(p. 59) DEPUTY CLERK: (e) Net income.

THE FOREMAN: Yes.

DEPUTY CLERK: (f) that Ernst & Whinney conducted its audit in accordance with generally accepted auditing standards.

THE FOREMAN: Yes.

DEPUTY CLERK: (g) that the financial statements taken as whole as qualified by the opinion of Ernst & Whinney presented fairly the financial position of the W. L. Jackson Manufacturing Company in accordance with generally accepted accounting principles.

THE FOREMAN: No.

DEPUTY CLERK: Pursuant to the instructions you then answered question two; is that correct?

THE FOREMAN: That is correct.

DEPUTY CLERK: Do you find by a preponderance of the evidence that any of the representations or omissions were made either (1) with knowledge that the statement was false or misleading or (2) with reckless indifference as to whether or not it was true. Your answer?

THE FOREMAN: Yes.

DEPUTY CLERK: And what are the letters that you identified?

THE FOREMAN: Yes, with respect to (c), and (f).

DEPUTY CLERK: Question three: With regard to those (p. 60) items identified in your response to question two, do you find by a preponderance of the evidence that Bradford-White (1) relied on the false statements or misleading omissions in deciding to buy the stock of W. L. Jackson Company, and (2) that it was reasonable to so rely? Your answer?

THE FOREMAN: Yes.

DEPUTY CLERK: And the letters you identified?

THE FOREMAN: Only with respect to (f).

DEPUTY CLERK: Number four: Were the representations by Ernst & Whinney made without any reasonable ground for believing it to be true and with the intent to induce others to rely upon it.

THE FOREMAN: Yes.

DEPUTY CLERK: Number five: Were the representations by Ernst & Whinney made with the intent to defraud others.

THE FOREMAN: No.

DEPUTY CLERK: Six: Do you find by a preponderance of the evidence that Ernst & Whinney failed to use the care and skill ordinarily used in like cases by reputable members of accounting profession practicing in the same or similar locality under similar circumstances?

THE FOREMAN: Yes.

DEPUTY CLERK: Number seven: Did Ernst & Whinney's failure as described in question six lead to a material (p. 61) misrepresentation or a material omission upon which Bradford-White relied? Your answer?

THE FOREMAN: Yes.

DEPUTY CLERK: Number eight: Was Bradford-White contributorily negligent?

THE FOREMAN: Yes.

DEPUTY CLERK: Nine: Do you find that Bradford-White's negligence is too far removed at to time or place for causative force to be a direct or proximate cause of the injury?

THE FOREMAN: No.

DEPUTY CLERK: You answered number ten; correct?

THE FOREMAN: Yes, we did.

DEPUTY CLERK: In what amount do you award damages?

THE FOREMAN: In the amount of $1,242,151.

DEPUTY CLERK: You answered question number 11?

THE FOREMAN: No we did not.

DEPUTY CLERK: That is the end of the questions, correct?

THE FOREMAN: Yes, it is.

MR. DENWORTH: May we have the jury polled, Your Honor?

DEPUTY CLERK: Juror Number One, would you stand please. Were the answers to the interrogatories just rendered here in open court your own true and correct (p. 62) answers to each and every interrogatory.

JUROR NUMBER ONE: Yes, they were.

DEPUTY CLERK: Juror Number Two, were the answers to interrogatories just rendered here in court your own true and correct answers to each and every interrogatory.

JUROR NUMBER TWO: Yes, they were.

DEPUTY CLERK: Juror Number Three, were the answers rendered here in court your own true and correct answers to each and every interrogatory.

JUROR NUMBER THREE: Yes.

DEPUTY CLERK: Juror Number Four, were the answers rendered here in court to the special interrogatories your own true and correct answer to each of the interrogatories?

JUROR NUMBER FOUR: Yes, they were.

DEPUTY CLERK: Juror Number Five, were the answers rendered here in Court to each of the interrogatories your own true and correct answers?

JUROR NUMBER FIVE: Yes.

DEPUTY CLERK: Juror number six, were the answers rendered here in open Court your own true and correct answers to each of the interrogatories.

JUROR NUMBER SIX: Yes.

DEPUTY CLERK: Juror Number Seven, were the answers rendered here in court your own true and correct answers to each of the interrogatories?

(p. 63) JUROR NUMBER SEVEN: Yes.

DEPUTY CLERK: Juror Number Eight, were the answers rendered here in court your own and correct answers to each of the interrogatories?

JUROR NUMBER EIGHT: Yes.

THE COURT: All right, ladies and gentlemen, that concludes your service as jurors in this case. It also concludes your service as jurors for this term of court. On behalf of the Judges and indeed all the citizens of the Eastern District of Pennsylvania, I want to tell you how much we really appreciate your giving up your time to come down here and serve as jurors, indeed because you served above and beyond the call of duty, by staying the extra two weeks.

It was a very difficult case for you to hear. But I could not help but notice the attention which you gave to this case and judging by the verdict sheet, your responses to these questions, it is pretty obvious you had a pretty keen understanding of everything that went on. So I think you are to be commended, and I think you ought to take pride in the fact you did come down here. This is the one area,

where you serve as part of the Government really on a volunteer basis.

I would like to believe that the judicial system is the cornerstone of our democracy. Without the judicial (p. 64) system standing between the Government and the citizens, and the judicial system which resolves disputes among the citizens, I don't think our form of Government would operate too well.

And with that, recognition, with the recognition of the fact that the jurors are the cornerstone of the judicial system, because as I have said without you people giving up your time to come down here to resolve these disputes, we would not be able to function. I hope you keep that in mind and realize that you have performed a very important function in the operation of the Government, and we really appreciate it.

I hope also that you found it an interesting and rewarding experience. You may be excused.

(The Jury left the courtroom.).

THE COURT: Well now as I read this verdict sheet, they found on the 10(b)(5) claim only with respect to (f), on the intentional misrepresentation they found in favor of Ernst & Whinney. On the negligent misrepresentation they found in favor of Bradford-White. On the negligent claim they found in favor -- well they found Ernst & Whinney was negligent, but they also found that the Bradford-White was negligent. And that the negligence was not remote. Thereby making contributorily negligent which would be a bar to any claim of negligence, so therefore the verdict on that count (p. 65) would be in favor of Ernst & Whinney.

The jury made an award of $1,242,151. We will enter a judgment in favor of the plaintiff and against the defendant in the amount of $1,242,151.

MR. DENWORTH: We would like to file motions.

THE COURT: You have ten days.

MR. DENWORTH: Ten days, Your Honor. Thank you.

MR. KITTREDGE: We will also be filing for present judgment interest, Your Honor.

THE COURT: Well I think it has to be for personal injury under the Pennsylvania rule. Did they change it?

MR. KITTREDGE: There is a liquidated amount we were suing for I believe.

THE COURT: It wasn't --

MR. KITTREDGE: I will submit it, Your Honor can consider it later.

THE COURT: I don't think the Pennsylvania rule applies to just liquidated amount or unliquidated, only as applies to unliquidated amount.

MR. KITTREDGE: That is rule 238. I am not going under rule 238.

(Court adjourned at 5:05 p.m.)